

USAID/Montenegro

Annual Report

FY 2005

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Please Note:

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Montenegro

Performance:

Background: Montenegro is one of two republics in the State Union of Serbia and Montenegro. According to the November 2003 population census issued by its Bureau of Statistics, Montenegro is approximately one-sixth the geographical size of Serbia with 616,000 inhabitants (less than one-tenth of Serbia's population). The ethnic composition is considered to be predominantly Montenegrin (43.16%) and Serbian (31.99%), with remaining 24.85% of the population defined as Bosniak (7.77%), Albanian (5.03%), Muslim (3.97%), Croatian (1.1%), Roma (0.42%), and other (6.56%). The number of refugees and internally displaced persons dropped from 31,700 in 2003 to 26,874 in 2004.

The signing of the March 14, 2002 Belgrade Agreement ended prospects for Montenegrin independence in the short-term in favor of a loosely federated union with Serbia. Parliamentary elections on October 20 of that same year gave the ruling coalition between the Democratic Party of Socialists (DPS) and the Social Democratic Party (SDP) an absolute majority in Parliament, enabling it to form a government on its own, and enabled ethnic Albanian parties to enter senior government positions. After holding the President's Office, Milo Djukanovic stepped down in order to become the new prime minister in January 2003. After three failed presidential elections due to turnout of the less than 50% required for valid elections, Montenegro finally elected Filip Vujanovic, the previous prime minister, as president in May 2003.

The 16 month opposition boycott of Parliament, in protest of the public television's decision to limit mandatory coverage, was resolved in October with the opening of the fall session. The boycott stalled any progress on addressing the myriad of political issues facing Montenegro and tensions between the two governing parties over the pace and character of political reform continue. In addition, the opposition's absence from Parliament prevented the overdue harmonization of the Constitution of Montenegro with the Constitutional Charter of Serbia and Montenegro, which the opposition insists requires a two-thirds majority. On the other hand, in the absence of a parliamentary opposition, the governing DPS and SDP had a productive legislative year, passing 63 pieces of legislation including the Law on Prosecution, the Criminal Law, the Law on Criminal Procedure, and other important reform laws under Economic Reform Agenda (ERA).

As 2004 comes to an end, tensions have increased over the state status of Montenegro. Although the European Union (EU) has made it clear that such a referendum cannot be held until 2006, the pro-independence and pro-union parties continue to disagree on Montenegro's future. The government has recently formulated a new concept for state status, i.e., a negotiated union of independent states. Other issues, such as Montenegro's state symbols, its official language, and the planned formation of a Council on Referendum, divide the Slavic population between those who define themselves as Montenegrins and those who see themselves as Serbs, and serves to distract attention from addressing the current difficult economic situation and implementing the needed economic reform process.

In the summer of 2003, the Serbian and Montenegrin governments managed to partially harmonize their economies in order to meet EU conditions for the Stabilization and Association Agreement (SAA). However, the EU stopped work on its SAA feasibility study in early 2004. Progress was stalled until September 2004, when the EU accepted a twin-track economic approach for Serbia and Montenegro that recognizes the states' fundamental economic differences, allowing work to begin again on the feasibility study, which is expected to be ready in early 2005.

The ERA remains the key tool used by the Prime Minister and his cabinet to drive and track the economic reform process in close coordination with other key stakeholders - including USAID, the European

Agency for Reconstruction (EAR), the World Bank (WB), and United Nations Development Program (UNDP) - in order to systematically review and discuss progress and develop concrete solutions to the inevitable impediments that arise. During FY 2004, USAID has largely focused on implementing the large body of legislation embodied in the ERA, while at the same time putting a few more key pieces of legislation into place. Nevertheless, inadequate attention to social safety-net issues could negatively affect public support for reform, which is crucial for the Government during the democratic transition. However, polling data indicate that public perception on the pace and results of reform remain divided: somewhat negative although slightly improving over last year (53% vs. 56% in 2003).

Montenegro's efforts to democratize have largely been supported since October 1997 by the U.S. and the EU through critical financial and technical assistance. The legislative and institutional frameworks needed for moving toward a consolidated democratic system, free market, and Euro-Atlantic integration have progressed significantly under the ERA launched by the Government of Montenegro (GOM) in March 2003 with substantial assistance from USAID, but much remains to be done. Society remains profoundly divided over the issue of redefining or terminating the relationship between Montenegro and Serbia, while systemic deficiencies, corruption, political patronage, and nepotism - ostensibly being addressed - continue to constrain the reform process. While the GOM must still pass some key pieces of legislation to address a variety of social, economic, and political problems, it must also continue to demonstrate the capacity to implement those laws that have already been adopted.

Despite the challenges ahead, it is fair to say that Montenegro is probably more politically and economically stable than it has been in over a decade. Inflation continued to fall from 7.5% in 2003 to 5% in 2004, the financial sector shows marked improvement and there is evidence that wages have risen. Although recent official data put the net wage at approximately 145 euros per month, other sources, including household-level surveys, indicate that income is about 250 euros per month. Nevertheless, active economic reforms have not yet led to markedly higher levels of growth or employment. The 2003 Poverty Reduction Strategy Paper reported an absolute poverty rate in Montenegro of 12.2%, with more than one-third of the population classified as economically vulnerable (19.3% in the north, representing 45% of the total poor in the republic). Among other economic indicators, GDP remains near 1990 levels (about 1.4 billion euros); unemployment once adjusted for the gray market remains around 17%. Montenegro continues to have a relatively high current account deficit, although the gap appears to be more than made up by unrecorded financing flows, including some portion of flows from tourism receipts that fall into the gray economy.

USAID interests and goals: The important geographical position of Montenegro in the Balkans and in Europe, along with its longstanding tenuous relationship with Serbia, has made Montenegro a primary locus for establishing stability in the region. Consequently, a stable democratic polity and growing market economy oriented toward Europe is vital to U.S. foreign policy interests.

Donor Relations: USAID remains the primary donor in Montenegro. The EAR, Germany, and the United Kingdom have smaller budgets and like USAID work in the areas of economic policy reform and enterprise development, civil society, media, and rule of law. The programs of the WB and the European Bank for Reconstruction and Development are principally focused on economic growth and infrastructure investments, while the International Finance Corporation (IFC) centers on Small and Medium sized Enterprise (SME) development. UNDP - with funding from the EAR, Germany, Canada, and the Netherlands - is working in the areas of the environment, enterprise development, and civil society. The Open Society Institute, the Organization for Security and Cooperation in Europe (OSCE), and the Council of Europe have small rule of law programs. Funding for humanitarian aid is much smaller than in previous years, with remaining programs coordinated by UNHCR. Coordination takes place at all levels, starting from the high-level collaborative framework of the GOM's ERA and continuing through regular meetings at the technical level of program managers and technical assistance implementers. USAID participates in donor coordination bodies on infrastructure and border crossings managed by the EAR; an environment donor coordination body managed by UNDP; and a reproductive health strategic working group with the World Bank and the British Department for International Development (DFID). In drafting their €5.5 million EU Community Assistance for Reconstruction, Development and Stabilization (CARDS) regional program to be implemented in 2005-07 primarily by the EAR, the European Commission

coordinated with USAID to ensure their efforts would complement US activities.

Challenges: Montenegro has operated for decades under a centralized system that has left citizens alienated and disengaged. Maintenance of and investment in local infrastructure and services have been severely neglected to a point of near collapse and serious ecological threat. Politicized intergovernmental financial flows and social services allocation left a vast number of population disadvantaged. Despite successful efforts to put into place progressive and innovative media legislation, challenges to the development of a truly independent sector remain. While improvements have taken place, especially in media capacity and competitiveness, quality and unbiased news are still the exception. The Non Governmental Organization (NGO) sector as a whole is not yet sustainable but significant improvements in the areas of advocacy, infrastructure, and public image have taken place in FY 2004. In the political party and parliamentary arenas, Montenegro still faces a hierarchy in which political leaders, party headquarters, and the Parliament maintain relatively closed decision-making processes, and Parliament as an institution lacks the ability to operate outside partisan politics and in the overall interests of the Republic. The judicial system, despite recently adopted progressive legislation, still remains weak and is struggling to support an effective market-driven economy that can attract foreign investment. Montenegro's history and culture as a patronage-based society, and the resulting corruption that this engenders, is a common thread that is woven through these issues.

Montenegro is disadvantaged by a small market with difficult access. Stimulating the private sector and attracting much-needed foreign investment remain the main challenges going forward. Most factors affecting development, though well within Montenegro's control, will require sustained political will to take difficult decisions. Private-sector development requires simultaneous progress on a number of different fronts. Now that a solid set of business laws are in place, implementation of judicial reform is critical to ensuring that these laws are uniformly enforced in a fair and effective manner. Labor markets maintain serious rigidities, with several layers of collective bargaining clouding and restricting employer rights. Infrastructure continues to be poor and badly under-financed, with the Government reluctant to charge cost-recovery rates or enforce collections at any level. Bank supervision has improved radically over the past few years, but continued mistrust of banks contributes to relatively low levels of deposits, despite strong growth, which in turn limits credit available and keeps interest rates high. Finally, despite vast improvement in the business registration process, rigidities, and discretionary applications of regulations remain. The ability and willingness of the Government to tackle these issues rests on two main pillars: social cost and the political will to tackle corruption.

Key achievements: In FY 2004, the Mission built on the legislative and institutional framework it helped to develop under the ERA and continued to be engaged in assisting and encouraging the Government in the implementation of its ambitious reform agenda. Significant implementation gains were made this past year in the financial sector, the economic reform agenda, tax administration, local governance and community revitalization, democracy and human rights, and the rule-of-law. This effectiveness is due in large part to the respect and confidence the GOM has in USAID, its programs, and program implementers. The continuing challenge in the coming years will be to accelerate the pace of the GOM's reform agenda while renewing people's confidence in the Government to improve the quality of their lives.

1. Financial sector: Substantial progress was recorded in the improved functioning of financial markets, as evidenced by actual growth in private bank deposits of over 35%. The financial sector is increasingly well-regulated according to Basel II core principles and off-shore banks have been eliminated. Although the level of deposits and consequently of lending has risen dramatically, they are still comparatively low. Effective implementation of deposit insurance according to the law, starting from mid-2004, should help alleviate some of the public mistrust towards banks. At the micro-level, the USAID-supported Opportunity Bank disbursed more than 8.3 million euros in SME loans over the last 12 months, leading to the creation of over 350 jobs and the maintenance of over 1,700 others.

2. ERA: Passage and implementation of key legislation has been instrumental in reducing barriers to starting and conducting business, including business registration, collateral registration, and foreign trade. Important on-going legislation in the final stages of passage includes licensing, domestic competition, and consumer protection. Although implementation of the new bankruptcy law has been mixed, with many

judges and trustees not yet understanding the restructuring provisions fully, on-going training and court administrative support is working to improve this situation.

3. Tax Administration (TA): On-going support to strengthen the operations of the TA has contributed to maintaining revenue flows, even as tax rates have begun to be cut. The continued development and transfer to the TA of systems for taxpayer data entry, return processing for monthly employer and employee contributions, and audit selection has supported its transformation to a modern and efficient tax administration.

4. Rule of Law: USAID through its Judicial System Reform Project (JSRP) provided expertise, training, and commodity assistance to improve the structure and operations of the judiciary, including creation of the new Appellate and Administrative courts and an Administrative Office. The president and judges of the Administrative court were appointed by the Parliament on December 14, 2004, while president and judges of the new Appellate court should be appointed by the end of 2004. In FY 2004, the new procedure for selection of judges has been put in force whereby the new Judicial Council nominates judicial candidates, eliminating involvement of the Ministry of Justice and participation of the executive branch. FY 2004 demonstrated a 48% positive score across 30 factors addressed in the Judicial Reform Index (JRI) when compared to the previous year.

5. Local Government: Under the Law on Local Government Finance, the municipal treasury model - including staffing, operations, and hardware and software - was developed with USAID assistance, and adopted by municipalities. Montenegro's administrative capital Podgorica put into operation the first municipal treasury, representing 60% of municipal revenues collected in the Republic. The Law on Direct Election of Mayors was tested through the smooth and valid execution of local mayoral elections in four municipalities. Local parliaments in 38% of Montenegrin municipalities have passed municipal charters, which are umbrella ordinances that direct the implementation of local self governance.

6. Community Revitalization: Communities throughout Montenegro have democratically elected and operated 114 community councils and 43 cluster councils representing the majority of the Republic's population. Collectively these councils have selected, designed, and carried out a total of 497 economic and social development projects in basic infrastructure, income and employment generation, environmental protection, and civic activities worth \$13,348,611 million in FY 2004. Community contribution averaged 45% of total project costs, and 9,127 person-months of employment and \$3,283,661 of income were generated.

7. Democracy and Human Rights: The USAID-funded Montenegro Independent Media Program concentrated on advancing the implementation of Montenegro's innovative media legislation primarily through providing expertise to Montenegro's New Public Broadcasting Service and Broadcasting Agency. The USAID-funded Montenegro Advocacy Program (MAP) built the capacity of civil society organizations to advocate successfully for legislative change on behalf of their constituents, successfully lobbying the Government to adopt or amend more than 25 key pieces of reform legislation. In the political arena, Parliament completed a final draft of the Rules of Procedures that should be adopted by the end of the year. USAID also provided support through the International Organization for Migration (IOM) for the institutional strengthening of a shelter for victims of human trafficking.

For more information please visit www.usaid.org.yu.

Gender implications: In USAID's Interim Strategic Plan for Serbia and Montenegro gender is a key cross-cutting issue. The gender issue is integrated and institutionalized at all stages of Mission's work, e.g. policy or activity planning, implementation, and monitoring and evaluation.

Results Framework

170-0130 Accelerated Development and Growth of Private Enterprise

SO Level Indicator(s):

Average Employee Salary Receipt (in Euros)

IR 170-0131 Increased Soundness of Fiscal Management

IR 170-0132 Improved Functioning of Financial Markets

IR 170-0133 Private Enterprises Strengthened

IR 170-0134 Enhanced Economic Soundness of Energy Sector

170-0200 More Effective, Responsive and Accountable Democratic Institutions

SO Level Indicator(s):

Public Opinion Polls (Public Confidence in Institutions)

IR 170-0201 Enhanced Capacity and Competitiveness of Independent Media

IR 170-0202 Strengthened Civil Society, Political Party and Trade Union Capacity to Serve and Represent Citizens

170-0210 Increased, Better Informed Citizens' Participation in Political and Economic Decision-Making

SO Level Indicator(s):

CRDA Communities Mobilize at Least 25% of Project Costs

IR 170-0211 Citizens Improve their Living Conditions through Participation in Community Development Activities

IR 170-0212 Improved Local Governance Performance

170-0410 Special Initiatives

170-0420 Cross-Cutting Programs